

COMMISSIONERS OF INLAND
REVENUE & ANOR.

v.

MOODIE AND ANOTHER APPEAL

HOUSE OF LORDS
LORD KEITH OF KINKEL,
LORD TEMPLEMAN, LORD GOFF
OF CHIEVELEY, LORD BROWNE-
WILKINSON, LORD MUSTILL
11 FEBRUARY 1993

REVENUE LAW: Income tax - Selfcancelling tax avoidance scheme - Effect of scheme to manufacture tax loss without taxpayer suffering any real loss - Whether effective to reduce liability to tax.

The respondents set in motion a series of transactions under a scheme known as the Cardale Capital Income Plan Mark I, a tax avoidance scheme, the object of which was the manufacture for the respondents of claims that they had reduced their income by the payment of annuities for which they were not liable to tax. The respondents did not in fact pay an annuity within the meaning of the taxing statute because the steps taken under the scheme were self cancelling.

The Court of Appeal allowed the respondents' claim and the Revenue appealed. The House of Lords was called upon to decide between two conflicting previous decisions on the same issue.

Held:

[1] The applicable principle was that laid down in *Ramsay's* case that it is the task of the Court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded.

[2] The circular book entries made in respect of the respondents were all preordained and made pursuant to a single composite contract. Upon a construction of the taxing statutes and in the events which happened no annuity was paid. The results of the scheme was to manufacture a claim by the respondents against the Revenue for a reduction in their taxable income.

- a [3] Faced with conflicting decisions, the Courts are entitled and bound to follow *Ramsay's* case because in *Plummer's* case the House was never asked to consider the effect of a self cancelling scheme and because the principle of *Ramsay's* case restores justice between individual taxpayers and the general body of taxpayers.
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[Appeals allowed with no order as to costs].

Cases referred to:

I.R.C. v. Plummer [1980] AC 896 (refd)
W.T. Ramsay Ltd. v. I.R.C. [1982] AC 300 (refd)
Eilbeck v. Rawling [1980] 2 All ER 12 at p. 21 (refd)
c *I.R.C. v. Burmah Oil Company Ltd.* [1981] 54 TC 200 at p. 214 (refd)
Furniss v. Dawson [1984] 1 AC 474 at p. 512 (refd)
Ensign Tankers (Leasing) Ltd. v. Stokes [1992] 1 AC 655 (refd)

Legislation referred to:

- d Income and Corporation Taxes Act 1970 ss. 3, 52, 108, 109, 434, 457, 528
Practice Statement (Judicial Precedent) [1966] 1 WLR 1234

JUDGMENT

- e **Lord Keith of Kinkel**

My Lords,

For the reasons given in the speech to be delivered by my noble and learned friend, Lord Templeman, which I have had the opportunity of reading in draft and with which I agree, I would allow these appeals.

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I would add only that, having been one of the majority in *I.R.C. v. Plummer* [1980] AC 896, I feel no doubt that upon the issues which were actually argued before the House, that decision was correct. On the other hand, I have equally no doubt that if the argument which was successful in *W.T. Ramsay Ltd. v. I.R.C.* [1982] AC 300 had been presented by the revenue in *Plummer's* case my conclusion would have been against the taxpayer.

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Lord Templeman

- h My Lords,

Income tax is a tax on wealth so that the higher the income of the taxpayer, the greater the amount of income tax which he must pay. Conversely, if a taxpayer reduces his income, he reduces his income tax. In 1971 there were

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in circulation a number of tax avoidance schemes which were designed to reduce the taxable income of an individual taxpayer without reducing his actual income. The Cardale Capital Income Plan Mark I was designed to enable a taxpayer to enjoy part of his actual income tax free by exploiting the fiscal treatment of annuities.

By the Income and Corporation Taxes Act 1970 an annuity payable for at least four years and fulfilling certain other conditions ceases to be the income of the payer and becomes the income of the annuitant. By ss. 108 and 109 of the Act of 1970 income tax is charged on the annuity and by ss. 52 income tax at the standard rate is deductible by the payer and retained by him if he pays the annuity out of his income. By ss. 3 and 528 the payer may deduct from his total income for income tax purposes the gross amount of the annuity. Thus the gross amount of the annuity is paid out of the actual income of the payer reducing his actual income and reducing his taxable income by the like amount. The annuity becomes the actual and taxable income of the annuitant. Tax at the standard rate is deducted by the payer of the annuity. If the payer certifies that he has paid the annuity out of his actual income and if the annuitant's total income does not render the annuitant liable to income tax at the standard rate then the annuitant can claim from the Revenue the amount of tax which has been deducted from the annuity so far as that deduction exceeds the amount of tax for which the annuitant is liable. But the taxable incomes of payer and annuitant are only altered if an annuity is paid and received.

In March 1971 the respondent Mr. Moodie paid a fee of £3,693 for the implementation of the Cardale Capital Income Plan Mark I. The following steps were taken on 8 March 1971:

- (1) The bankers SW advanced £59,400 to Hovas, a charitable trust company formed for the purposes of the plan.
- (2) Hovas paid £59,400 to Mr. Moodie in consideration of his covenanting to pay Hovas for five years, or, if shorter, the remainder of his life an annuity at such a rate as should equal £12,000 after deduction of tax at the standard rate. The first payment was to be made on 29 March 1971 and subsequent payment on each 29 March.

- a (3) Mr. Moodie paid £59,400 to Old Change Court (Investments) Ltd. (OCC) a company comprised in the SW group of companies in consideration for ten promissory notes for £60,000. The notes were deposited by Mr. Moodie with Hovas as security for the payment of the annuity of £12,000 pursuant to Step (2).
- b (4) OCC advanced £59,400 to Baldrene Ltd., another SW company.
- (5) Baldrene advanced £59,400 to Hovas.
- (6) Hovas paid £59,400 to SW in discharge of the advance made under Step (1).
- c On 29 March 1971 and the four succeeding anniversaries of that date the following steps were taken pursuant to the plan:
 - (7) OCC paid £12,000 to Mr. Moodie in redemption of two of the promissory notes in discharge of its obligations under Step (3).
- d (8) Mr. Moodie paid £12,000 to Hovas to discharge his agreement to pay an annuity under Step (2).
- (9) Hovas paid Baldrene £12,000 in part discharge of the advance under Step (5).
- (10) Baldrene paid OCC £12,000 in part discharge of the advance under Step 4.
- e With the benefit of the hindsight afforded by the speeches of this House in *W.T. Ramsay Ltd. v. I.R.C.* [1982] AC 300 ("*Ramsay's case*") it is now plain that Mr. Moodie did not pay an annuity within the meaning of the taxing statute because the steps taken under the plan were self cancelling. The payments and receipts were recorded as book entries but it would have made no difference if payment had been made by cash or cheque. The plan provided that all ten steps should be taken and that no one should be financially better off or worse off. The Cardale Capital Income Plan was a tax avoidance scheme which had no object or effect save the manufacture for Mr. Moodie of claims that he had reduced his income by sums which amounted in the aggregate to £99,460. He had not reduced his actual income and had not been put to any capital expense save the cost of the scheme which amounted to £3,693. In due course Mr. Moodie's claims were disallowed by the Inspector of Taxes, the Special Commissioners and Hoffman J. but were allowed by the Court of Appeal (Balcombe and McCowan LJ and Sir Christopher Slade). The Revenue now appeal.
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The respondent Mr. Sotnick paid a fee for the Cardale Capital Income Plan Mark II. That plan incorporated variations from the Mark I plan but the results were similar. The plan Mark II was a tax avoidance scheme which manufactured claims by Mr. Sotnick that he had reduced his taxable income by sums which in the event amounted in the aggregate to £69,576. These claims were also allowed by the Court of Appeal and the Revenue now appeal.

In 1971 Mr. Plummer took advantage of the Cardale Capital Income Plan Mark I. In his case there were manufactured claims by Mr. Plummer that he had reduced his taxable income by some £20,000 and those claims were allowed by this House in *I.R.C. v. Plummer* [1980] A.C. 896 (*“Plummer’s case”*). In the instant cases the Court of Appeal allowed the claims of Mr. Moodie and Mr. Sotnick on the ground that the Court was bound by the result in *Plummer’s case*. It is quite clear that the facts in *Plummer’s case* were almost exactly the same as and cannot be distinguished from the facts in the case of Mr. Moodie or the facts in the case of Mr. Sotnick. On behalf of Mr. Moodie and Mr. Sotnick it is submitted that the House is bound by the result of *Plummer’s case* to allow the claims of Mr. Moodie and Mr. Sotnick.

Plummer’s case came before the House in 1979. The annuity was £851.06 and the capital sum was £2,500. The Revenue made four submissions, each of which, if accepted, would defeat the claim of Mr. Plummer:

- (1) That a payment made under Step (8) was the payment of an annuity but that the annuity was not paid out of income but out of the capital paid under Step (2).
- (2) That a payment made under Step (8) was paid by means of the promissory notes obtained under Step (3) and was not paid out of Plummer’s income.
- (3) That the consideration for the annuity namely the sum paid by Hovas pursuant to Step (2) was not “valuable and sufficient consideration” and the annuity fell to be disregarded under s. 434 of the Income and Corporation Taxes Act 1970.
- (4) That the steps constituted a settlement within s. 457 of the Act of 1970, that Mr. Plummer was the settlor and that the annuity payments remained part of his

a total income for income tax purposes by virtue of that section.

The four submissions made on behalf of the Revenue were rejected by this House. On the assumption, accepted by all parties, that payments were made in implementation of each of the planned ten steps which constituted the scheme, this House decided that Step 8 was the payment of an annuity out of income since the taxpayer’s actual income exceeded the gross amount of the annuity. The payments of the annuity were not made out of the capital constituted by the promissory notes. The consideration for the annuity was good and sufficient. There was no element of bounty so there was no settlement. On the assumption that Mr. Plummer paid an annuity, *Plummer’s case* was rightly decided for the right reasons.

c In the light of the submissions made by the Revenue and the presentation of the facts in *Plummer’s case* the failure of the Revenue against Mr. Plummer was inevitable.

The argument that a self cancelling tax avoidance scheme was effective to reduce tax was ridiculed in the Court of Appeal in *W.T. Ramsay Ltd. v. I.R.C.* [1979] 1 WLR 974 and rejected in *Eilbeck v. Rawling* [1980] 2 All ER 12 at p. 21. When these two cases came before the House of Lords in January 1981, the Revenue “mounted a fundamental attack upon the whole of the scheme acquired and used by the appellant. It contended that it should simply be disregarded as artificial and fiscally ineffective”; per Lord Wilberforce in *Ramsay’s case* at p. 321. That attack succeeded. In *Ramsay’s case* the taxpayer claimed to have made an allowable loss for the purpose of capital gains tax but when the scheme was analysed it was plain that the taxpayer by self cancelling transactions made neither a loss nor a gain. In *Eilbeck v. Rawling* also, the scheme manufactured a tax loss by self cancelling transactions without the taxpayer suffering any real loss. Lord Wilberforce laid down the applicable principle as follows at pp. 323-324:

f It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded.

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Lord Fraser of Tullybelton discussing the schemes in *Ramsay's* case and in *Eilbeck v. Rawling* said at pp. 337-8:

The essential feature of both schemes was that, when they were completely carried out, they did not result in any actual loss to the taxpayer. The apparently magic result of creating a tax loss that would not be a real loss was to be brought about by arranging that the scheme included a loss which was allowable for tax purposes and a matching gain which was not chargeable. In *Ramsay* the loss arose on the disposal of the appellant's shares In *Rawling* it arose on the disposal of the appellant's reversionary interest.... But it is perfectly clear that neither of these disposals would have taken place except as part of the scheme, and, when they did take place, the taxpayer and all others concerned in the scheme knew and intended that they would be followed by other prearranged steps which cancelled out their effect There is, therefore, no reasons why the court should stop short at one particular step The absence of contractual obligation does not in my opinion make any material difference.

The effect of *Ramsay's* case was underlined by Lord Diplock in *I.R.C. v. Burmah Oil Company Ltd.* [1981] 54 TC 200 at p. 214 as follows:

It would be disingenuous to suggest, and dangerous on the part of those who advise on elaborate tax avoidance schemes to assume, that *Ramsay's* case did not mark a significant change in the approach adopted by this House in its judicial role to a preordained series of transactions (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable.

The effect of *Ramsay's* case was further elucidated in *Furniss v. Dawson* [1984] 1 AC 474 by Lord Fraser of Tullybelton at p. 512 as follows:

The true principle of the decision in *Ramsay* was that the fiscal consequences of a preordained series of transactions, intended to operate as such, are generally to be ascertained by considering the result of the series as a whole, and not by dissecting the scheme and considering each individual transaction separately.

Lord Bridge of Harwich said in *Furniss v. Dawson* at p. 517:

It would need no more than a cursory exposition of the avoidance schemes in *Ramsay* and

Eilbeck v. Rawling to lead any intelligent layman to the conclusion that neither scheme was designed to achieve any substantial effect in the real world and that the elaborate steps designed to manufacture a tax deductible loss in each case were purely formal in character.

Lord Brightman in *Furniss v. Dawson* discussing *Ramsay's* case said at pp. 522-523:

Features of the scheme were as follows:

1. There was no commercial justification for the scheme. There was no prospect of a profit. In fact there was bound to be a small loss in the form of the fees and similar expenses which would be payable.
2. No step in the scheme was a sham. Every step was genuinely carried through, and was exactly what it purported to be.
3. There was no binding arrangement that each planned step would be followed by the next planned step, but it was reasonable to assume that all the steps would in practice be carried out.
4. The scheme was designed to, and did, return the taxpayer to the position which he occupied before it began, except for the payment of the expenses of the scheme.
5. The money needed for the various steps was lent by a finance house on terms which ensured that the loan came back to the finance house on completion; the taxpayer's personal outlay was confined to his expenses of the scheme.

The authorities which preceded and followed *Ramsay's* case were discussed in *Ensign Tankers (Leasing) Ltd. v. Stokes* [1992] 1 AC 655. For present purposes it suffices that an application of the *Ramsay* principle to the facts in *Plummer's* case must have led to a decision in favour of the Revenue. In *Ramsay's* case the taxpayer did not make a loss. In *Plummer's* case Mr. Plummer did not pay an annuity.

Similarly Mr. Moodie did not pay an annuity. Book entries were made which purported to record that OCC paid £12,000 to Mr. Moodie who paid £12,000 to Hovas which paid £12,000 to Baldrene which paid £12,000 to OCC. These circular book entries were all preordained and made pursuant to a single composite contract effected on 8 March 1971. Upon the construction of the taxing statute and in the events which happened no annuity was paid. The results of the scheme were to manufacture a claim by Hovas against the Revenue for repayment of tax and to manufacture a claim by Mr.

Moodie against the Revenue for a reduction in his taxable income. So too, Mr. Sotnick did not pay an annuity.

Mr. Thornhill on behalf of Mr. Moodie and Mr. Sotnick made a number of gallant attempts to argue that *Plummer's* case and the present appeals were distinguishable from *Ramsay's* case but all these attempts foundered because they depended on the assertion that the taxpayer in each case paid an annuity to Hovas. If *Plummer's* case had been decided after *Ramsay's* case, the Revenue would have succeeded, though not on any of the grounds advanced in *Plummer's* case. The present appeals are heard after *Ramsay's* case and this House is bound to give effect to the principle of *Ramsay's* case. I do not consider that it is necessary to invoke the *Practice Statement (Judicial Precedent)* [1966] 1 WLR 1234 which allows the House "to depart from a previous decision when it appears right to do so". The result in *Plummer's* case (which is a decision of this House) is inconsistent with the later decision in *Ramsay's* case (which is also a decision of the House). Faced with conflicting decisions, the Courts are entitled and bound to follow *Ramsay's* case because in *Plummer's* case this House was never asked to consider the effect of a self cancelling scheme and because the principle of *Ramsay's* case restores justice between individual taxpayers and the general body of taxpayers. I agree with the Special Commissioners and Hoffmann J. that the Cardale Capital Income Plans are struck down by the *Ramsay* principle and that the inconsistent decision in *Plummer's* case must be ignored. If it were necessary to invoke the *Practice Statement* I have no doubt that this would be an appropriate course to take but in my opinion it is sufficient to state that the decision in *Plummer's* case would have been different if the appeal had been heard after the enunciation by this House of the *Ramsay* principle.

After *Ramsay's* case the Chancellor of the Exchequer announced that the decision had saved the Revenue and thus the general body of taxpayers sums of about £300 million. We were told that the results of the present appeal will decide the fate of claims to millions of pounds by taxpayers who are in the same position as Mr. Moodie and Mr. Sotnick. On their behalf Mr. Burton advanced several submissions designed to show that the application of the *Ramsay* principle to Mr. Moodie and Mr.

- a Sotnick and others would be unfair. But his real complaint was that the Cardale Capital Income Plan succeeded for Mr. Plummer but fails for everybody else. The Revenue failed against Mr. Plummer because the *Ramsay* principle had not been adumbrated by the House at that time. The Revenue succeed now because the *Ramsay* principle applies.
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I would allow the appeals. The Court of Appeal in giving leave to the Revenue to appeal to this House imposed terms namely that the Revenue would not seek to disturb the order for costs made by the Court of Appeal and would not ask for an order for costs against the respondents in this House. There will therefore be no order for costs.

Lord Goff of Chieveley

My Lords,

- d I have had the advantage of reading in draft the speech prepared by my noble and learned friend Lord Templeman, and for the reasons he gives I, too, would allow the appeals.

Lord Browne-Wilkinson

My Lords,

- e I have had the advantage of reading the speech prepared by my noble and learned friend Lord Templeman, and for the reasons he gives I, too, would allow the appeals.

Lord Mustill

- f My Lords,

I have read the speech prepared by my noble and learned friend Lord Templeman, and for the reasons he gives I, too, would allow the appeals.

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